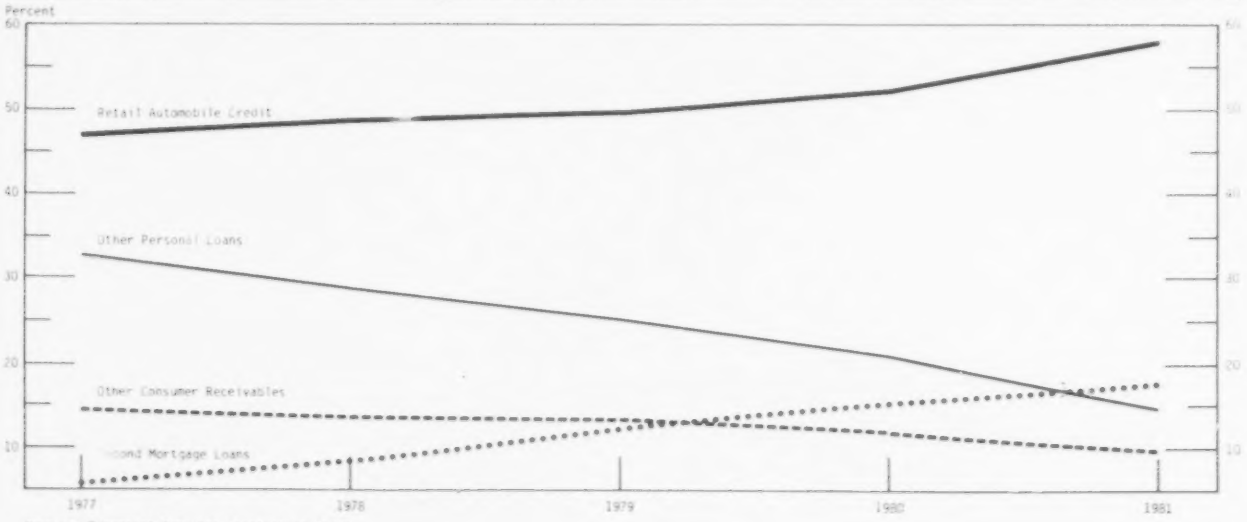
A1615-1 3/9/83

FinanceFacts

A Monthly Publication on Consumer Financial Behavior FEBRUARY 1983

Percentage Distributions of Consumer Receivables at Finance Companies
1977-1981



American Financial Services Association Chart
Source: American Financial Services Association

Inflation, recession, financial deregulation, and the rapid pace of change in recent years have focused widespread public attention on evolution in the nation's financial institutions and markets. Traditional financial institutions have entered new markets and provided new financial products. At the same time, nonfinancial firms have newly entered financial markets either by acquiring existing firms or by starting financial subsidiaries. The speed of these changes, coupled with two recessions in the past three years, has raised many questions about trends among traditional financial competitors, including finance companies. To provide some answers, AFSA Research Services has produced a new report examining five-year trends in finance companies' consumer credit, 1977-1981. The report employs a consistent sample of companies over the period (adjusted for mergers) in order to avoid sample biases arising from variations in coverage. The sample includes thirty-five of the companies with the largest portfolios of consumer receivables, including eighteen of the largest twenty. Although this sample obviously is not randomly selected, its coverage suggests that importance may be attached to the trends observed. The thirty-five companies account for more than 75 percent of Federal Reserve estimates of total finance company personal loans outstanding and more than 85 percent of estimates of finance company automobile credit.

As discussed more fully in Finance Facts in June 1982, finance companies' consumer credit has grown more rapidly in recent years than consumer credit at the other major consumer creditors - commercial banks and credit unions. At

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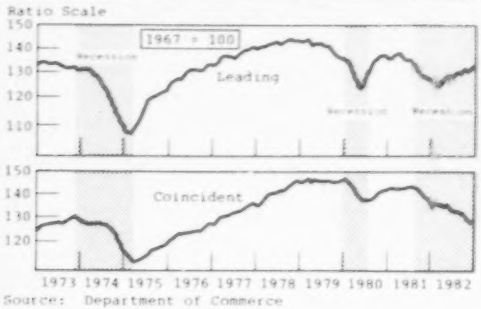
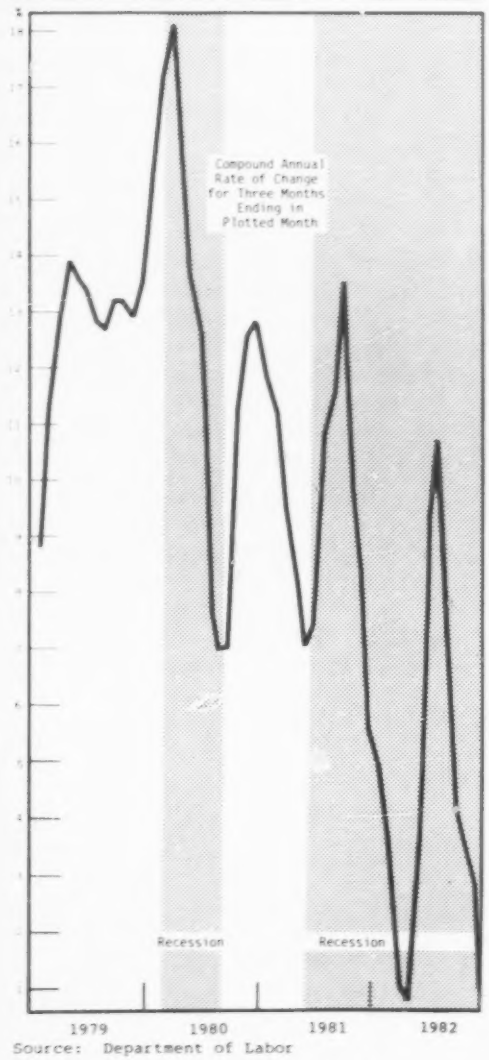
Composite Indexes By Months 1973-1982



Source: Department of Commerce

Change in Consumer Price Index

(All Urban Consumers, 1979-1982)



Source: Department of Labor

LEADING ECONOMIC INDICATORS

The composite index of leading indicators increased 1.5% in December to a level of 132.8 (1967=100), according to preliminary data. Based on more complete data, this index increased 0.2% in November and increased 0.3% in October. The December increase is the fourth in as many months and the eighth increase in the last nine. Of the ten components that made up the indicators for December, six increased, three declined and one was unchanged. The leading indicators ended 1982 up 4.5% from the end of 1981.

The composite index of coincident indicators, which is a monthly approximation of aggregate economic activity, decreased 0.1% in December to a level of 128.2 (1967=100), based on preliminary data. November's index was down 0.2% and October was down 1.5%, based on more complete data. The composite index ended 1982 off 6.1% from December 1981.

CONSUMER INSTALLMENT CREDIT

At year end 1982, consumer installment credit outstanding amounted to $343.4 billion before seasonal adjustment. Led by automobile credit, the December increase was $2.19 billion after seasonal adjustment, following a $2.52 billion gain during November and a decline of $0.32 billion in October. The December increase was equivalent to almost an 8% annual rate of growth. Growth in consumer installment credit for the year was 3.5% with an annual rate of growth in the fourth quarter of over 5%.

PRICE INDEXES

The Consumer Price Index for All Urban Consumers (CPI-U) declined 0.3% in December, on a seasonally adjusted basis. This decline follows an increase of only 0.1% in November and, with March 1982, was only the second decline in the seasonally adjusted index since August 1965. Primary responsibility for the decrease in the overall index was the decrease in the housing index (0.8%), due to a sharp drop in mortgage interest rates. The apparel and upkeep and the food and beverage components also registered declines, down 0.4% and 0.1%, respectively. Before seasonal adjustment the CPI-U declined 0.4% in December to 292.4 (1967=100).

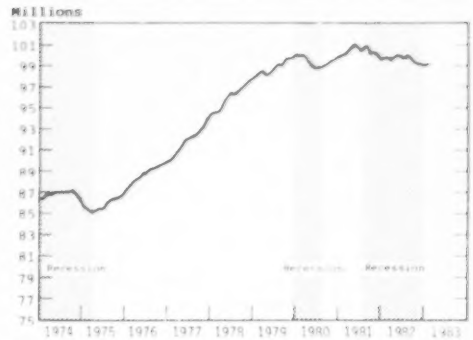
For the twelve months ended in December, the CPI-U rose 3.9%; this compares with a rise of 8.9% in 1981 and is the smallest December-December rise since the 3.4% in 1972.

EMPLOYMENT

Unemployment declined in January after seasonal adjustment and the number of nonfarm jobs increased. A new overall unemployment rate introduced with the January data, which includes the resident Armed Forces in the labor force, was 10.2%, down from 10.7% in December. The unemployment rate for all civilian workers was 10.4%, down from 10.8% in December. Total employment was unchanged in January, seasonally adjusted, at 100.8 million. Nonfarm payroll employment rose by 340,000. Additionally, both the total private and factory workweeks advanced sharply. Within the industry groups that have been most severely hit by the recession, manufacturing and construction, jobless rates declined during January by 1.8% and 2.0%, respectively.

Total Civilian Employment

By Months (Seasonally Adjusted) 1974-1983



Source: Department of Labor

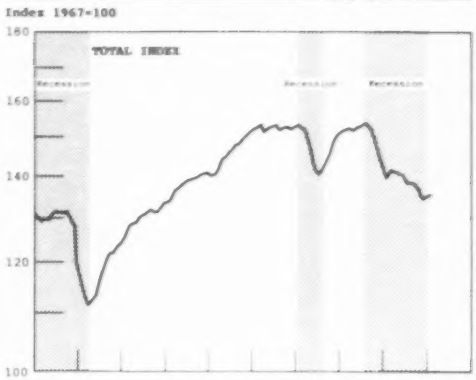
PERSONAL INCOME

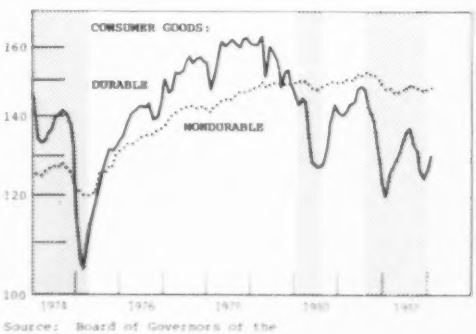
In December, personal income increased $15.5 billion to a seasonally adjusted annual rate of $2,636.8 billion. Personal outlays increased $6.3 billion to $2,106.4 billion. In November, personal income increased $9.8 billion and personal outlays increased $22.9 billion.

For 1982, personal income increased 6.4%, compared with an 11.8% increase in 1981. Disposable personal income (DPI) increased 7.1% in 1982; it increased 11.2% in 1981. In real dollars, DPI increased 1.1% in 1982 and increased 2.5% in 1981. As measured by the personal consumption expenditure implicit price deflator, prices increased 5.9% in 1982 compared with an 8.6% increase in 1981. In 1982 the saving rate was 6.5%, in 1981 it was 6.4%.

Index of
Industrial Production

by months (seasonally adjusted) 1974-1983





Source: Board of Governors of the Federal Reserve System

INDUSTRIAL PRODUCTION

In January, industrial production increased by an estimated 0.9% after a revised 0.1% gain in December. In both months large increases occurred in the output of automotive products and defense and space equipment. In January the production of construction supplies and basic metals, particularly steel, also advanced sharply. At 136.2% of the 1967 average, industrial production in January was 11.5% below its latest high in July 1981 but 1% above the November 1982 low.

Output of consumer goods rose 0.9% in January due to autos and home goods production. Output of nondurable consumer goods edged up with increases in food and clothing partially offset by a decline in consumer energy products.

Gregory D. Luetscher

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the sample companies, consumer receivables were up 98 percent 1977-81 from $38 billion to $75 billion. Personal loans rose 66 percent over the period and automobile credit increased 145 percent. Based on Federal Reserve Board estimates of credit outstanding at all consumer creditors, the finance company share of total consumer credit outstanding rose from just under 20 percent in 1977 to more than 27 percent in 1981 and 1982.

Within the finance company industry, possibly the most noteworthy trend in the consumer portfolio during these years (beyond overall growth) is the switch from unsecured to secured lending. For example, the chart shows retail automobile credit increasing from 47 percent to 58 percent of sample companies' gross consumer receivables 1977-81. Likewise, secured second-mortgage personal loans rose from 6 percent of gross receivables to 17 percent. In contrast, unsecured personal loans - long a staple of the consumer finance industry - dropped from 33 percent to 15 percent. By 1981 unsecured personal loans totalled less than second mortgages for the first time in the industry's history. Moreover, "other" consumer receivables, including (secured) mobile home credit but dominated by (in effect unsecured) smaller ticket durable goods and appliance credit, fell from 14 percent to under 10 percent of gross consumer receivables 1977-1981.

There are many reasons for the recent increase in finance companies' secured lending relative to unsecured. One is the high cost of funds in the past few years that has increased the attractiveness of making larger loans since larger loans carry less overhead expense per loan dollar. Generally, before lenders make large loans they want collateral of some sort. Another reason for increased secured lending is consumers' enhanced real estate equity due to inflation in real estate values. Higher equity permits its use as security. Since large, secured loans often are available at lower cost than unsecured credit, consumers frequently prefer the second mortgage approach. Another reason is the rapidly escalating bankruptcy losses on unsecured credit since the 1978 revisions to the Federal Bankruptcy Code (see Finance Facts for December 1982). All consumer creditors' losses due to personal bankruptcies are estimated as high as $6 billion per year 1981-82. In this environment it is not very surprising to see creditors trying to minimize their exposure on unsecured credit.

Thomas A. Durkin

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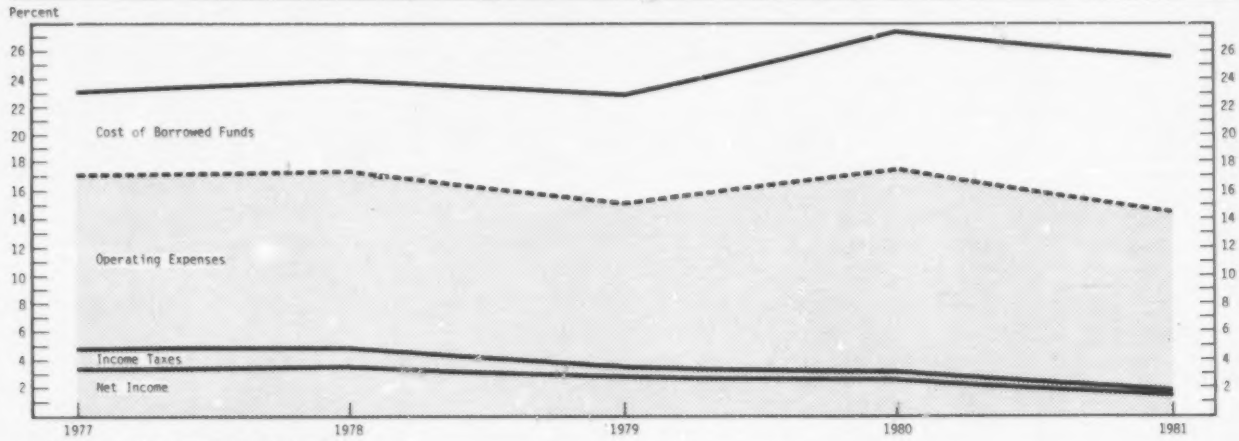
FinanceFacts

A Monthly Publication on Consumer Financial Behavior MARCH 1983

Gross Income, Expenses, and Net Income of Personal Loan Companies
as a Percent of Receivables
1977-1981



American Financial Services Association Chart
Source: American Financial Services Association

The sharp fluctuations in market interest rates in recent years have increased public attention to the course of financial markets and the behavior of financial institutions. Most recently, the sharp declines in short-term market rates since the summer of 1982 have raised questions in many newspapers, and even in Congressional hearings, about spreads between consumer credit rates and lenders' costs of funds. Consumer creditors, so the argument goes, have systematically widened consumer credit spreads to cover their shaky loans to distressed business firms and foreign governments. Unfortunately, this view overlooks much of the economic theory of interest, and ignores available evidence on the operations of credit markets.

Rather than concentrating on the complexities of interest-rate theory, though, this month's Finance Facts studies the widening-margin question by examining the lending spreads of finance companies making consumer personal loans. Data have been provided by 26 large companies of the American Financial Services Association that concentrate on personal lending. In 1981 more than 77 percent of the receivables of these companies were in the form of personal loans to consumers, and together they held 57 percent of Federal Reserve Board estimates of finance company personal loans outstanding nationwide. Because of their importance

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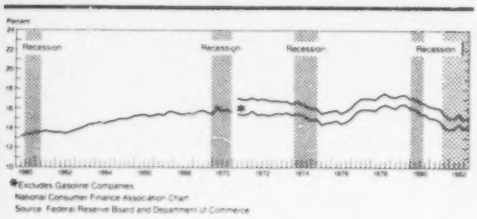
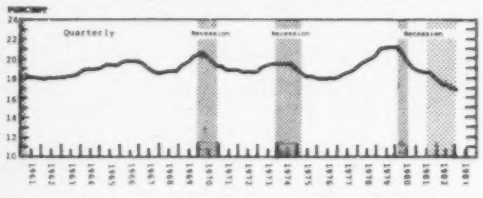
Ratio of Repayments of Consumer Installment Credit to Disposable Personal Income



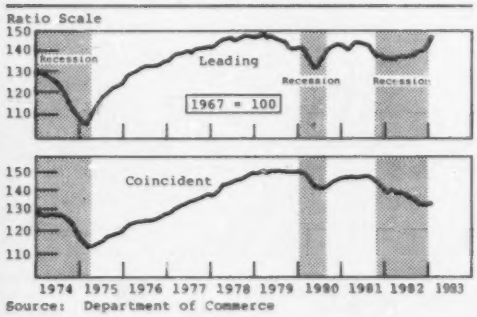
*Excludes Gasoline Companies
National Consumer Finance Association Chart
Source: Federal Reserve Board and Department of Commerce

Ratio of Consumer Installment Credit Outstanding to Consumer Sector's Liquid Assets



National Consumer Finance Association Chart. Source: Federal Reserve Board

Composite Indexes By Months 1974-1983



Source: Department of Commerce

CONSUMERS' FINANCIAL POSITION

Personal saving as a percent of disposable personal income dropped to 6% in the fourth quarter from 7% in the third. Consumer installment credit outstanding increased 1.2% in the fourth quarter following a 0.2% increase in the third. The ratio of installment credit repayments to disposable personal income rebounded to 15.4% in the fourth quarter from its low point of 14.9% in the third. Installment credit outstanding as a percent of consumers' liquid assets (currency, deposits and money market mutual fund shares) continued it's downward trend ending the year at 17%, down from 18% in the fourth quarter 1981 and 19% at the end of 1980.

CONSUMER INSTALLMENT CREDIT

Consumer installment credit increased $2.93 billion in January, on a seasonally adjusted basis. The December increase was a revised $2.42 billion. The January advance was equivalent to a 10.5% annual rate of growth, compared with an 8.5% rate in December and 4% for the entire year 1982. The bulk of the January increase in outstandings was accounted for by the large "other" category - primarily personal cash loans and sales finance contracts for non-automotive goods - amounting to $2.18 billion. The strongest component in December was auto credit but the January increase was less than $250 million. At the end of January 1983 consumer installment credit outstanding amounted to $343.4 billion before seasonal adjustment.

ECONOMIC INDICATORS

The composite index of leading indicators increased 3.6% in January to a level of 146.3 (1967=100). The index increased 0.4% in November and 0.8% in December. (The data have been revised back to 1948. The last revision was in 1979.) The leading index has now increased for nine of the past twelve months and is at its highest point since June 1979. Of the ten indicators available for January, nine increased. Contracts and orders for plant and equipment in 1972 dollars was the only declining indicator. If the January increase is not substantially revised downward next month it will be the largest one month gain since before 1974.

The composite index of coincident indicators, which is a monthly approximation of aggregate economic activity, increased 0.6% in January to a level of 132.8 (1967=100). The index decreased 0.2% in December.

Gregory D. Luetscher

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CONSUMER SECTOR INDICATORS

	1980 IV	1981 IV	1982 I	1982 II	1982 III	1982 IV
EMPLOYMENT, INCOME, AND SPENDING						
Employment - Household Survey 1/	99,515	100,087	99,660	99,720	99,605	99,135
Disposable Personal Income 2/	$ 1,902.9	2,101.4	2,117.1	2,151.5	2,198.1	2,227.1
Personal Consumption Expenditure 2/	$ 1,745.8	1,884.5	1,919.4	1,947.8	1,986.3	2,031.5
Personal Saving 2/	$ 105.3	158.6	139.1	144.3	152.0	135.5
CONSUMER INSTALLMENT CREDIT						
Total Outstanding 3/	$ 309.1	327.9	330.0	333.5	334.0	338.1
Percent Change	1.2	0.4	0.6	1.1	0.2	1.2
Ratio to Consumers' Liquid Assets (%)	19.0	18.0	17.7	17.6	17.2	17.0
Ratio: Repayments to Disposable Personal Income (%)	16.3	15.1	15.1	15.6	14.9	15.4
Market Share (%)						
Commercial Banks	46.9	44.8	44.8	44.2	44.0	44.0
Finance Companies	24.5	26.9	27.4	27.8	27.7	27.9
Credit Unions	14.1	13.8	14.0	13.8	13.9	13.9

1/ Excludes Resident Armed Forces. Thousands, seasonally adjusted quarterly average
2/ Billions, seasonally adjusted annual rate
3/ Billions, seasonally adjusted

Source: Federal Reserve Board, Bureau of Labor Statistics, U.S. Department of Commerce, AFSA.

The above data are updates and revisions to data last presented in the December 1982 issue of Finance Facts. Estimates are revised periodically by the statistical agencies to incorporate methodological changes and new source data.

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in the industry, these companies provide an excellent sample to use in studying industry trends.

The top line in the chart illustrates the gross revenues of these 26 large companies (including interest, insurance profits, and foreign and miscellaneous net income) in relation to their year-end domestic receivables 1977-81. The distance between the top line in the chart and the dotted line is these companies' cost of borrowed funds relative to domestic receivables. The widening space in the chart clearly illustrates the escalating costs of funds during these years. Subtracting costs of borrowed funds from gross revenues yields gross margins available for operating expenses (including losses), taxes, and profits. This gross margin in relation to receivables may be seen as the shaded area in the chart. Rather than a rising margin over time, the chart shows a relatively steady margin before a substantial drop in 1981.

At this time, 1982 results have not yet been received from member companies and compilations will not be available for some months. Nevertheless, subject to revision as the data become available, a few likely features seem predictable. First, borrowed funds costs in relation to receivables may have dipped somewhat in 1982, although this is not at all certain because rates remained very high in 1982 by historical experience. Second, it seems likely that firms probably attempted to maintain or raise charges wherever possible in 1982 in order to restore gross margins to historical levels. Of course, increasingly competitive personal loan markets may have forestalled this possibility for many companies. Thus, gross margins probably did not widen very much in 1982. Third, it seems reasonable that the sharp cost cutting and movement toward secured lending that characterized 1981 continued in 1982 (see Finance Facts for January 1983). As a result of all these changes, net profit probably improved somewhat in 1982.

Nonetheless, available evidence on finance companies does not support the hypothesis that they have kept rates high to widen margins compared to historical experience. Higher funds costs have forced finance companies to look for new revenues in recent years, but margins still have narrowed rather than widened. While it seems likely that firms in 1982 probably attempted to increase margins over the year before, 1981 margins were very narrow by historical standards, and it is not at all clear that firms would have been able to widen them very much. As a result, it seems probable that cost cutting continued in 1982 along with maintenance of the longer-term trend away from costly unsecured lending.

Thomas A. Durkin

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FinanceFacts

A Monthly Publication on Consumer Financial Behavior APRIL 1983

Some Observations on Financial Institutions

Technology, high interest rates, and emergence of new financial products have renewed the old debate over the role of government in the American financial system. Proposals for deregulation, reregulation, and "level playing fields" dominate the financial press. Even among the public at large there is heightened awareness of developing changes in the nation's financial structure. Because of the widespread interest in the evolving financial system, from time to time Finance Facts will offer some random observations on financial institutions and markets.

In a large, complex economy like that of the United States, there constantly are participants - including individuals, businesses, and governments - who have resources available beyond their current spending needs and who want to invest them. Likewise, at any time there are others in the economy who have additional needs for current funds and who want to borrow. Together these needs provide an economic role for financial institutions in the economy - to facilitate the transfer of funds.

Essentially, a financial institution facilitates funds transfers by behaving in either of two ways: 1) by serving as a broker who brings together the lender and the borrower, or 2) by becoming a "financial intermediary." A financial intermediary is simply a financial institution that truly stands in the middle. It borrows on its own account from those who supply the funds and then it lends the funds (maybe in different amounts, for different maturities, or with different risk characteristics) to those who need them. For providing this intermediation service the financial institution earns a profit. It is clear that to earn its profit the intermediary's services must be useful to both the suppliers and users of funds. If the services were not useful or attractive, then borrowers and lenders would deal directly with one another, possibly employing a broker.

There are many examples of financial intermediaries in the American economy. Probably the best known are the commercial banks, but there are also thousands of savings and loan associations, savings banks, credit unions, finance companies, life insurance companies, pension funds, and mutual funds. All are regulated to varying degrees under numerous Federal and state laws and by hundreds of Federal and state regulatory bodies and agencies. Especially since the Great Depression of the 1930's, restrictions on which kinds of institutions can provide which kinds of intermediation services have been an important part of this regulatory apparatus.

However, even if there were not so many governmental restrictions on the activities of the various types of financial intermediaries, it is not at all clear that all financial institutions would be the same or that financial services would be provided only by a few giant institutions. A number of economic factors suggest otherwise.

First, differences in management abilities and expertise - part of what economists refer to as "information cost differences" - inevitably are going to lead to specializations. There likely will always be financial institutions that specialize in specific services to consumers, to farmers, to small businesses, or to multinational corporations. Even if some firms become large enough to develop multiple specialties,

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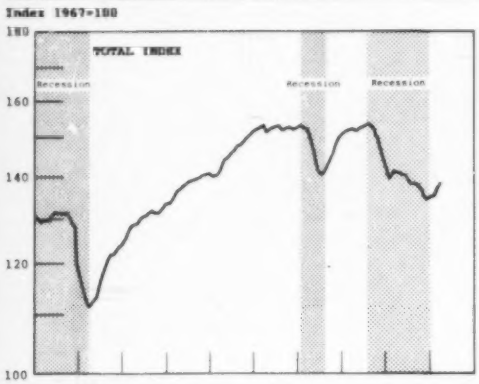
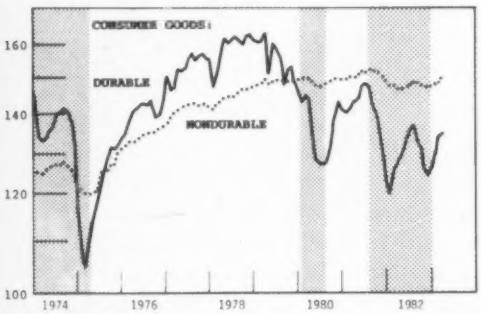
Index of
Industrial Production
by months (seasonally adjusted) 1974-1983





Source: Board of Governors of the
Federal Reserve System

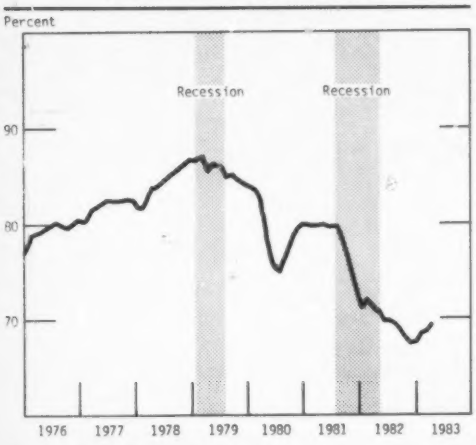
INDUSTRIAL PRODUCTION

Industrial production increased 1.1% in March after rising 0.3% in February and increasing 1.5% in January. In March, large gains were registered in the output of construction supplies, durable and nondurable materials and consumer goods other than autos and appliances. The index, at 139.1 (1967=100) in March, has risen more than 3% from its November low. This increase reflects significant gains in the output of automotive products, construction supplies and durable materials (especially steel). Production of consumer goods rose 0.8% in March for the fourth consecutive monthly gain. Gains in the output of nondurable consumer goods were widespread.

GROSS NATIONAL PRODUCT

Real gross national product increased 3.1%, or $11.3 billion, in the first quarter of 1983 according to preliminary estimates. (All quarterly estimates are seasonally adjusted annual rates). In the fourth quarter of 1982, real GNP declined 1.1%, or $3.9 billion. Current-dollar GNP increased 9.1%, or $68.5 billion, in the first quarter while prices as measured by the GNP implicit price deflator increased 5.8%. In the fourth quarter, current-dollar GNP increased 2.6%, or $20.0 billion, while the GNP implicit price deflator increased 3.7%. The increase in first-quarter real output occurred as inventory liquidation continued, but at a lower rate than in the fourth quarter.

Capacity Utilization -
Total Manufacturing



Source: Federal Reserve Board

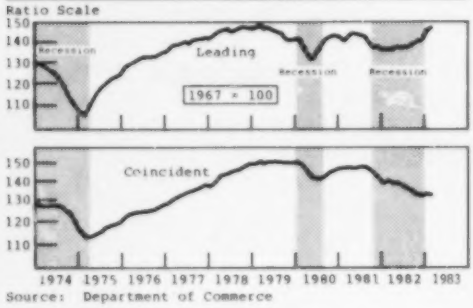
CAPACITY UTILIZATION

Capacity utilization in manufacturing rose 0.7 percentage point in March to 69.4% reflecting widespread increases in activity among manufacturing industries. Producers of industrial materials gained 0.8 percentage point in March, operating at 68.5% of capacity, resulting mainly from strong advances in the production of durable materials - especially metals, equipment parts and parts for durable consumer goods. The operating rate for the motor vehicles and parts industry decreased a little but remained well above the fourth quarter level. Producers of durable goods materials posted a third monthly sizable gain in capacity utilization in March, up 1.7 percentage points to 63.2%. The rate of nondurable goods materials was up a more moderate 0.7 percentage point to 73.3%.

LEADING ECONOMIC INDICATORS

The composite index of leading indicators increased 1.4% in February to a level of 148.3 (1967=100) on a preliminary basis. Based on more complete data, the index increased 3.5% in January and 1.1% in December. The preliminary estimate for January had been a 3.6% increase. The February increase was the sixth consecutive increase and the ninth increase in the past twelve months and places the index at a point exceeded only in March 1979. Of the ten indicators available for February, seven increased and three declined. The composite index of coincident indicators, which is a monthly approximation of aggregate economic activity, declined 0.2% in February to a level of 133.2 (1967=100). The index increased 1.1% in January and decreased 0.2% in December, based on more complete data. The preliminary estimate for January had shown an increase of 0.6%.

Composite Indexes By Months
1974-1983



Source: Department of Commerce

CONSUMER INSTALLMENT CREDIT

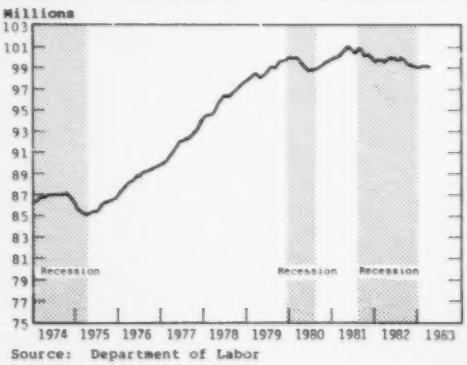
In February, consumer installment credit outstanding increased $1.74 billion on a seasonally adjusted basis. In January, the increase was $2.93 billion. The February rise was equivalent to a 6% annual rate of growth, down from the 10.5% rate in January but still above the 4% annual rate for the full year 1982. The category having the largest contribution to the February increase was the "other" category (primarily personal cash loans and non-automotive sales finance contracts), up $1.35 billion. This category also showed the strongest rate of increase in January. Automobile credit growth remained near the very moderate January level and revolving credit showed virtually no growth in February.

EMPLOYMENT

Both employment and the rate of unemployment were about unchanged from February to March, on a seasonally adjusted basis. The overall unemployment rate, including resident Armed Forces, was 10.1% and the rate for civilian workers was 10.3%, both near the February levels but about half a percentage point below their December highs. Total employment remained at about 100.8 million. Civilian employment was at about 99.1 million and has shown little movement since last October. Since last March the civilian labor force has grown by about 1.1 million.

Total Civilian Employment

By Months (Seasonally Adjusted) 1974-1983



Source: Department of Labor

Gregory D. Luetscher

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this does not mean they will be able to dominate the market unless they can provide the services at lower cost. Thus, costs and economies of scale are important considerations for market structure.

Second, there simply is no evidence that many financial services, including consumer financial services, are subject to significant operating cost economies of scale (cost advantages for larger institutions). As a result, larger institutions cannot drive out smaller ones. Thus, we see, for example, smaller banks and finance companies existing and thriving alongside larger ones.

Third, on the demand side, it is by no means clear that everyone wants to deal solely with giant financial department stores instead of small specialists any more than they want to deal solely with giant retailers to the exclusion of boutiques. Many users of financial services probably care more about the price and the quality of the services than about whether they can satisfy all their financial needs with one provider.

In sum, there are powerful economic factors suggesting that even in a deregulated environment where all financial institutions could freely invade others' markets there would still be a diversity of providers of financial services. Neither cost nor demand factors argue that loosening of current governmental restrictions would inevitably produce giant conglomerates that could eliminate all other financial intermediaries from the market. Rather, in a deregulated environment there likely would be some large diversified institutions that would be subject to competition from smaller specialized firms. Neither type would be able to eliminate the other. The public would be able to choose among the providers of financial services and financial markets would be more competitive. Consequently, in evaluating the arguments concerning financial deregulation, it seems that public policy makers should carefully examine the benefits of enhanced competition.

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